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THE
GEORGE WASHINGTON UNIVERSITY
NAVY GRADUATE COMPTROLLERSHIP PROGRAM

THE NAVY INDUSTRIAL FUND

By
Commander John A. Donnelly, U. S. Navy

For
Dr. A. Rex Johnson

May, 1956.

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CHAPTER I

INTRODUCTION - THE BACKGROUND OF THE INDUSTRIAL FUND

During the post-war decade, the Navy has changed radically in size and complexity; accompanying this readjustment process has been a shifting of emphasis from the absolute control of personnel and materiel to greater considerations of the cost and efficiency of this control.

The problem of Military Management is how to effect the optimum reconciliation between maintaining the Services at the highest degree of efficiency and highest level of potential, with insuring that the taxpayer is getting the maximum amount of service for each dollar expended.

With this end in view, the financial systems and procedures within the Navy are being designed so as to encompass and approximate many of the methods used in our business economy. These Naval systems are not static; in the quest for the best way to insure this optimum dollar return, they are in an ever-dynamic state of flux. In an effort to apply the practice and procedures of modern business to military establishments, the Industrial Fund method of financing is being instituted in stations of all the Services.

It is the intent of this paper to examine the reasons for this novel financial system; to weigh its advantages and disadvantages, contrastive with the current allotment system; and to discuss briefly how it operates from the viewpoint of the field activity Comptroller. The subject matter of the paper is derived from the homogeneous correlation of the divers facts

CHAPTER I

INTRODUCTION - THE BACKGROUND OF THE PROBLEM

During the past few years, the Navy has shown increasing interest in the development of a system for the control of its activities. This interest has been expressed in a number of ways, including the establishment of a system for the control of its activities, the establishment of a system for the control of its activities, and the establishment of a system for the control of its activities.

The purpose of this study is to examine the Navy's interest in the development of a system for the control of its activities. This study will examine the Navy's interest in the development of a system for the control of its activities, the Navy's interest in the development of a system for the control of its activities, and the Navy's interest in the development of a system for the control of its activities.

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and theories gleaned from the Navy Comptrollership Course, and the Defense Department contacts resulting therefrom. The anticipation of a duty assignment that will require a degree of familiarity with the Industrial Fund provided the motivation for the discussion in this and the following Chapters.

The Hoover Commission reports in 1949 were extremely emphatic in their advocacy of modern, more efficient financial management within the Federal Government:

Some of the fiscal concepts of the federal government came down from Alexander Hamilton. They were archaic when the total expenditures of the government were four billion dollars per annum. Now, with a government which expends over forty billion dollars per annum, they are totally inadequate. They have been patched up over the years, but even so, they contribute to wasted effort and even defeat the capable management and initiative of the best of officials.¹

These reports resulted in an era of newfledged and increasing emphasis on federal financial management. The Title IV Amendments to the National Security Act of 1947, which were enacted by the Congress in 1949, had the express purposes of instituting uniform budgetary procedures within the Department of Defense - and of improving the financial structure of military organizations by the establishment of the Comptroller function within the Army, Navy, and Air Force. A very significant measure was also taken by the authorization and advocacy of working capital funds "for such industrial type activities and for such commercial-type activities as provide common services within or among the departments and agencies of the Department of Defense, as he (the Secretary of Defense) may

¹The Commission on Organization of the Executive Branch of the Government, Budgeting and Accounting, a Report to the Congress, February 1949, p. 1.

The former Commission's records in 1966 were extremely meagre in their coverage of reports, and although the Commission is now more active, its records are still very limited.

The above information was obtained from the records of the Federal Government and is being furnished to you for your information.

These copies remain in an old unclassified and unmarked
copies of Federal Bureau of Investigation. The first is numbered in the
Federal Bureau of Investigation of 1967, which was received in the Bureau in 1967,
and the copies remain in the Bureau of Investigation of 1967.

It is the policy of the Department of Defense to provide information to the public in a timely and accurate manner. This document contains information that is classified as "Confidential" and is not to be released to the public without the approval of the Department of Defense.

1. The purpose of this study is to determine the effect of the use of the computer on the learning of the English language.

designate.²

By Public Law 216, the Secretary of Defense was authorized to capitalize inventories on hand; beginning 1 January, 1955, sums necessary to provide working capital could be appropriated as necessary from any otherwise unappropriated surplus in the Treasury.

Accordingly, in July 1950, the Secretary of Defense established an Industrial Fund within each of the three Departments. Each Fund is to consist of unexpended cash balances in the Treasury; accounts receivable; stores of supplies, materiels and work-in-process; finished goods, and all other current assets pertaining to or acquired in the operations of those establishments financed by the fund, subject to all liabilities incurred in connection with these operations. Plant and equipment used in operating these establishments do not constitute a part of the fund.³

This directive was the culmination of the efforts and advocations of Mr. W. J. McNeil, Assistant Secretary of Defense (Comptroller), Secretary of the Navy James Forrestal (member of the 1949 Hoover Commission), and Mr. Herbert Hoover, Chairman of the 1949 Commission on Organization of the Executive Branch of the Government. Extremely encompassing in its scope, its coverage included the following aspects of the new system:

- a) The purposes of Industrial Funds.
- b) A description of the charter proposed for any installation.
- c) Governing regulations for the proper handling of assets and liabilities; cash requirements; receipts, and inventory.

²U. S. 81st Congress, the National Security Act Amendments of 1949 - Public Law 216, Sec. 405.

³Department of Defense, Regulations Covering the Operation of Working Capital Funds for Industrial - and Commercial - Type Establishments, p. 2.

- d) Methods for charging and billing ordering agencies.
- e) Reimbursement procedures, to maintain the pre-determined level of working capital.
- f) Cost accounting methods.
- g) Procedures for obligations and expenditures.
- h) The co-ordination of Industrial Fund activity, and budgetary control.
- i) Reports required.
- j) Auditing.⁴

Compliance with this Department of Defense directive has been effected to varying degrees within the three services. Preparedness subcommittee No. 3 of the U. S. Senate found that as of November, 1953, the Army had brought only nine operations under the Industrial Fund, the Air Force one, while the Navy, as the most progressive of the Services had chartered twenty-eight Industrial Fund enterprises. The success experienced by these converted stations emphasizes the desirability that all arsenals, ordnance plants, clothing factories, repair shops, shipyards, transportation services, printing plants, etc. be converted as expeditiously as possible.⁵

As of this writing, the Navy has over forty activities in operation under the Industrial Fund. This includes Shipyards, Printing Plants, Research and Development Laboratories, the Military Sea Transportation Service, and other programs. The Naval Air Station is the next potential

⁴Ibid; passim.

⁵Preparedness Subcommittee No. 3 of the Committee on Armed Services, United States Senate, Implementation of Title IV, National Security Act of 1947. (Washington: Government Printing Office, 1954.)

5) The coordination of industrial zone activity and behavior

2. *voluntas* 11

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field for this type of financial operation. Currently, the team from the Office of the Comptroller (Navy) and the Bureau of Aeronautics are investigating the feasibility of installing the Industrial Fund at the Naval Air Station, Quonset Point, Rhode Island, with an anticipated cut-over date of about February, 1957.

Thus, the Industrial Fund has made impressive advances in revolutionizing our system of financial management. It would seem timely, at this point to examine its mechanics - to see precisely what it is, and how it functions.

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CHAPTER II

THE SUBSTANCE AND CONTRIBUTIONS OF THE NAVY INDUSTRIAL FUND

Essentially, the Industrial Fund is a radical departure from the Appropriation system of financing the operation of an activity engaged in industrial or commercial type endeavours. Under the Appropriation system, a station is financed through Appropriations from several Bureaus, and through numerous allotments within each appropriation. For example, a typical Naval Air Station has, from the Bureau of Aeronautics, fourteen allotments, for Station Maintenance, Aircraft Operations, Aircraft Overhaul, Ground Electronics, etc; from Bu Docks, four allotments, while the Bureau of Ordnance, the Bureau of Medicine and Surgery, the Bureau of Personnel and the Bureau of Supplies and Accounts also have their own specific appropriations and subheads against which the costs of station operations must be charged.

Were this station to be chartered as an Industrial Fund enterprise, it would receive one no-year, or continuing administrative allocation of cash from the consolidated Treasury account for the Industrial Funds of the three Services. This administrative allocation of cash to our typical station is made by the Navy Department, with the approval of the Comptroller of the Secretary of Defense; it is also subject to periodic re-adjustment.

When chartered, the Industrial Fund Activity is theoretically

Scientific, the Industrial Bank is a radical departure from the

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LA UNIVERSITAT DE VALÈNCIA

2. The first of these is the fact that the system is not a closed system. It is open to the environment, and this means that it can exchange energy and matter with the outside world. This is a very important feature of the system, as it allows it to adapt to changes in its environment. For example, if the temperature of the environment increases, the system can absorb heat and use it to do work. This is a very useful property, as it allows the system to maintain its internal state even when the external conditions change.

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10. In writing and printing, use the following abbreviations:

[illegible]

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the Commission of the Secretary of Defense; it is also subject to review

... ..

a self-sufficient entity. All costs and expenses are capitalized, or "full-costed", and become a part of the finished goods transferred to the consumer activity, or are spread among charges for services rendered.

Inasmuch as prices for civilian labor, and prices for raw materials remain the same regardless of the method of financing, it would appear on the surface that the ultimate costs would be identical albeit paid for by different commands. As an over-simplified illustration, let us assume that a squadron has purchased 10,000 gallons of an aviation fuel, at a cost of \$.30 per gallon. The amount chargeable to the squadron is the actual price of the fuel, or \$3000. Chargeable to the various allotments of the servicing activity are the costs of civilian labor, \$120.00, and the costs of fuel used to operate delivery equipment, maintenance of this equipment, etc., in the amount of \$96.00.

Under the full-costing, Industrial Fund concept, the charges to the squadron are \$3000 for materials used, \$120.00 for direct labor, and 80% of the direct labor cost, or \$96.00 for overhead expenses. The total costs are the same, but borne differently between the activities.

Why, then is it desirable to use the Industrial Fund method of operation? Some of the significant reasons follow; other comparisons between the working capital system and allotment financing will be examined later:

The Industrial Fund permits local management to exercise more operating latitude than is customary under allotment financing, with control by Bureau primarily through review of results rather than by detailed fund restrictions.

Funds are related directly to workloads; therefore, reduction in personnel, inventories, and other costs are encouraged when workload decreases. Increases are automatic with an increase in workload.

Thus, concentration on work, rather than on obtaining funds, is permitted.

Attention is concentrated on unit costs; since the customer is a critic of the price charged for products and services, minimizing of costs and increase of efficiency is enforced. There is a positive incentive to economy to replace negative incentive of fear of possible future cuts if all allotted funds are not spent.

Eliminates to a great extent "free issue" material and "free" services, tending to engender a greater sense of responsibility in use of materials and services.

Provides financial reports (and, if required, operating reports) suitable for review by Navy, Army, and Air Force comptrollers, Dept. of Defense, and Bureau of Budget. Review of these reports tends to invite management review of operations at these levels unless clear understandings with respect to responsibility are reached.

Tends to reduce any incentive for duplication of facilities at an installation due to separate channels of financing.

Requires that budgets for products and services be prepared to include all costs (except military labor, certain free issue component parts handled as "Government Furnished Material," and depreciation) of the product or service, including overhead and material or services which may otherwise be "free." Conversely, all elements of cost being funded in relation to workload, imbalances in funding for support functions (supply support, for example) can be avoided.

Facilitates use of accrual accounting, which relates cost to the time period in which incurred regardless of date of subsequent "expenditure." This includes accrual of employee's annual leave liability.

Facilitates use of double-entry accounting, which provides certain checks on accounting accuracy difficult to achieve otherwise.⁶

In short, the institution of the Industrial Fund system of financial management as an activity is not of itself the accomplishment of an end objective. The Fund is merely a means to an end. By encouraging

⁶Bureau of Aeronautics, "Check List of Basic Differences Between Use of Working Capital Fund and Allotment Financing for Operations of Field Installations." (Mimeographed).

There, communication is more, rather than of individual kinds, is
permitted.

Attention is concentrated on what matters; alone and somewhat in
a sense of the whole through the process of division, resulting
of some kind instead of attention is required. There is a sensitive
reactive to sensory in relation to the nature of the of growth
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a pride in the statistical revelation of operating efficiency, and forcing a full realization of cost consciousness through all organizational levels, it renders possible many economies, and pinpoints areas of inefficiency. Indeed, an activity chartered under this fund cannot long exist without complete financial control and efficiency.] It must be realized that the purchasing units do have a certain freedom of choice in respect to many goods and services "paid for" by them; they must certainly balk if forced to bear the burden of excessive overhead rates, or any charges not in keeping with a norm. Oftimes, as any irate customer, they may "take their business elsewhere."

The Industrial Fund Activity is essentially a business venture; its financial operation is extremely similar to any reasonably large manufacturing concern in private industry. The three major differences are:

1. There is no necessity of provision for Federal taxes.
2. Where a private business is naturally conducted to maximize profit, the Industrial Fund concern must attempt to show a profit of zero on its financial statements.
3. Land and plant (permanent assets) are not capitalized under the Industrial Fund; hence the depreciation of certain accounts is not costed.

The primary instrument for maintaining financial control is the General Ledger; it contains the summary and controlling accounts for each major financial element of the Industrial Funded activity. At any closing date, it shows the financial condition and operating results of

There is no doubt that the Government is doing its best to protect the public interest, and that the public interest is the best interest of the country. The Government is doing its best to protect the public interest, and the public interest is the best interest of the country.

The Industrial Fuel Activity is considered a business activity.

1. There is no necessity of providing for Federal aid.

2. There is a Federal aid in the form of a loan to the States.

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the station. Ordinarily, it is in the three major sections:

1. The Financial Section; this contains the accounts for:
 - a) Assets; cash, accounts receivable, inventories, work in progress.
 - b) Liabilities; amounts owed to employees and others.
 - c) Capital; amounts owed the U. S. Government, resulting from initial capitalization of inventories, project cash authorizations, modified by earnings or deficits from operations.
2. The Income and Expense Section; this is a summary of the operating and other income, the operating costs, production and general expense and applied overhead accounts.
3. The Statistical Section; all accounts, such as plant property, depreciation, payment of military personnel, that do not come under the Fund.

Under the Industrial Fund, accounting is on an accrual basis; all labor and material is costed at the time work is performed and material is consumed. Operating expenses are also accrued - utilities, fuel, rental, etc. This avoids any undue distortion of costs for any period.

This process, of operating on an accrual accounting system, and requiring periodic operating statements, readily lends itself to management review. The financial reports made invite criticism of operations on a trend basis, permissive of analysis of current results, and also of projected operations. In this vein, it has been found that the combination of double entry bookkeeping and accrual accounting has greatly enhanced the effectiveness of the internal review operation:

the situation. Ordinarily, it is in the latter major sections:

1. The statistical section; this contains the accounts for:

- a) assets; b) liabilities; c) income; d) expenses; e) other.

in progress.

b) liabilities; accounts used in operations and others.

c) capital; accounts used in the U.S. Government, resulting

from initial capitalization of investments, profits and distributions,

results by means of detailed from operations.

2. The income and expense section; this is a summary of the

operation and other income, the operating costs, production and general

expenses and capital overhead accounts.

3. The statistical section; all accounts, such as first

property, depreciation, payment of property taxes, loss of net worth

under the law.

Other than the statistical data, information is in the latter section;

all items and material is stated in the form of a narrative and subject

in summary. Operating expenses are also shown - capital, fixed, variable,

etc. This avoids any undue duplication of costs for any period.

This process, of operating on an actual accounting system, and

resulting results operating statements, results in the latter to manage-

ment review. The financial reports with various details of operations are

a form basis, consisting of analysis of various results, and also of

financial operations. In this form, it has been found that the classification

of items with comparison and control regarding the results achieved in

extraneousness of the internal review operation:

The establishment of an effective internal review program has been facilitated as a result of operating under the Industrial Fund. The double entry bookkeeping system and the accrual costing procedure under the Industrial Fund permit the internal review organization to delve into operations and tie them to financial statements. At a recent internal review conference held at the Naval Armament Depot, Hastings, Nebraska, it became apparent that stations operating under the modified Industrial Fund would have much greater difficulty in developing a thorough internal review program.⁷

From the general ledger described above is taken the data to make up the Balance Sheet and Profit and Loss Statement of the Industrial Fund activity, with supporting schedules; these ordinarily are summary reports of comparisons of actual and budgeted costs for each cost center, detailed overhead expenses, and other schedules as required.

The station comptroller, acting in a staff capacity is responsible for the institution and review of managerial procedures for budgeting, accounting, statistical reporting and internal control. He assists the Commanding Officer in financial policy matters, program planning, and related areas of financial administration. It is probably in the budget area that his responsibilities are most demanding. The formulation of a realistic and exact budget is imperative; in keeping with the modern tendency in American business, "management by exception" plays an important part. In the Industrial Fund operation, deviation of any cost center from its planned budget is the signal for management action; hence the insistent requirement that all elements of proposed work-load and management policies be considered. Some examples that must receive consideration in this respect are: what is the anticipated policy in regard to labor increase

⁷Cdr. James M. Brogan, SC, USN, "Navy Industrial Fund Operations at Naval Ordnance Plant Forest Park, Illinois", Navy Comptroller Review, March, 1956, p. 11.

or cut-back? What seems to be in the offing in regard to wage-rate changes? What is management policy and intent with respect to plant and equipment improvement or replacement?

Each designated cost-center should be budgeted on a quarterly basis, and should receive periodic reports and analyses of its operation; these reports, prepared by the budget division of the Comptroller Department must emphasize deviations from the planned budget - again "management by exception." It is particularly essential, in budgeting for the industrial-type activity that the optimum amount of flexibility be granted. This is imperative because of the constantly changing workload, with the attendant changes in overhead rates for administrative and general expenses; it is difficult at best to plan the workload for a period of any longer duration than one quarter - hence the need for the utmost flexibility. Cost-center budgets must lend themselves to ready revision and co-ordination. This same principle is applicable on a grander scale, at a higher administrative level:

It must be recognized that annual budgets of industrial-fund activities are very rough, and that, in fact, it is not possible to tell at the time of preparing the annual budget, for inclusion in the President's budget to Congress, precisely what work will be scheduled at each installation. An annual budget prepared at the beginning of each fiscal year should be much better, yet, even so, it must be recognized that the work-load of each installation is not firm at this time.⁸

Proper and effective use of the budget is one of the foremost requisites of successful Industrial Fund operation; it must be understood and respected at all levels:

⁸Navy Comptroller's Office, "Budget Examination of Industrial-Fund Activities." Mimeographed.

What matters more than anything else is surely that there should be general recognition of the essential part played by financial control in management. Financial control must not be regarded as a formidable obstacle that has to be overcome, before some new undertaking can go ahead, still less as a constable to be outwitted, if need be by some clever dodge.

Once it is understood that financial control is an essential function of management, it follows that every individual on the staff of any authority or enterprise should regard it as an inherent and inescapable part of his job to do his business in an orderly and prudent way, which will prevent waste.⁹

⁹Sir Edward Bridges, G.C.B., G.C.V.O., M.C., Financial Control: It's Place in Management, (London: MacDonald & Evans Ltd., 1951), p. 1.

CHAPTER III

ALL THAT GLITTERS - - -

Previous chapters have extolled the virtues of the Industrial Fund; the more rabid protagonists of this system hail it as the ultimate solution to all financial infirmities. However, a word of caution must be interposed. It would appear possible that, succumbing to human frailties of judgment, and to an over enthusiastic regard for one's own position and responsibilities, the institution of the Industrial Fund could be made when such institution is actually unnecessary:

Having devoted so much space to the reasons for changing the organization, we hasten to add that in each case one should carefully consider possible reasons for avoiding it. There is a great deal of wisdom in the old proverb, "Let sleeping dogs lie." Change is always disturbing, however good its purposes may be. People fear what they do not understand fully. And sometimes their fears are justified. Changes may be made at the wrong time, in the wrong way; they may hit carefully established and smoothly working informal patterns. Let these warnings be underscored by another admonition: "Look before you leap." Too often the decision to reorganize is based merely on a hankering for "order" or "procedure," or simply on the human desire for a change.¹⁰

It must be emphatically reiterated that Public Law 216 authorized establishment of the Industrial Fund for "industrial-type activities and for commercial-type activities." It seems self-evident that a shipyard, or a gun factory is an industrial type activity; in these installations the primary mission is the production of finished goods, on a large scale,

¹⁰E. Dale, Planning and Developing the Company Organization Structure (New York: The American Management Association, 1952), p. 125.

for "purchase" by a consumer activity. In other situations wherein the establishment of the Industrial Fund is contemplated, there exists some doubt as to the advisability of this system's use rather than the more simplified allotment method. For an example, on a Naval Air Station, none of the operations - save that of the Overhaul and Repair Department - can be visualized as "industrial" or "commercial" in nature. There may be two or more transient squadrons based on the station; possibly there is a detachment of a Sea-Air-Rescue Coast Guard unit attached to the station; ordinarily one or more Service Squadrons will be aboard; while other functions - Fleet Logistics Terminals, Communications Centers, etc., are activities not commonly associated with overhead expense in a truly industrial station.

Thus are some unique and self-evident problems posed. On the assumption that the station as an entity is placed under the Industrial Fund, the overhead rates charged to customers to defray the expenses incurred by support of these non-profitable tenants must, of necessity, be gigantic. Assuming the selectivity of consumers is inviolate, transient aircraft, and those based aboard in all probability would rely on other stations for routine services at a more reasonable charge to their allotments.

One alternative becomes apparent immediately; make the financing of the Overhaul and Repair Department independent of the particular Naval Air Station, and by the Industrial Fund system; the station itself will remain on an appropriation/allotment system. However, certain difficulties must be overcome in this situation also. An aircraft Overhaul and Repair

Department, by the very nature of its operation renders any system of cost accounting and application of overhead extremely complex. The workload is fluctuating; the technological methods and systems used are fluid due to the number of different airframes, engines and equipments worked on. Thus overhead rates are difficult to standardize - and particularly difficult to apply to the job on which the overhead is incurred.

Another complication arises from the employment of this system. That is the problem of effecting a compatability between the use of the Industrial Fund for one Department of a station and the use of allotment financing for all other Departments of this station. It must be borne in mind that Industrial Fund accounting of itself is not noted for its simplicity:

Requires somewhat more complex financial accounting system than does allotment accounting, but simplifies fiscal accounting in cases where an installation is financed from numerous sources or by numerous separate allotments, project orders, etc.

Requires an accounting staff at each installation with understanding of commercial accounting. General level of accounting proficiency must be higher.

Poses problems of meshing industrial fund accounting with government fiscal accounting and disbursing, e. g. cash reconciliation, payment by industrial fund installation for work done by other installations, accounting for "tenant" activities, etc.¹¹

Granted that the Industrial Fund system does tend to promote economy and efficiency by highlighting areas of excess cost and by the promotion of cost-consciousness, it nevertheless, by virtue of its inherent complexity, requires a greater personnel staff to fulfill its bookkeeping requirements. We have seen that a typical station may be

¹¹Bureau of Aeronautics, "Check List of Basic Differences," op. cit., p. 3.

financed by means of dozens of allotments. This in itself does not seem desirable, because of the multiplicity of reports required. However, the Industrial Fund requires volumes of reports, to be at all meaningful. Each cost center for a station must be staffed so as to maintain and submit exact figures on material, wages and overhead items. These figures must be analyzed by a central administrative staff organization; in turn, reports must be sent by this body to the cost centers, to appraise them of their performance, and to establish and maintain proper standards. This gives rise to the problem of allocation of costs - an important problem, since accurate cost accounting is the basis for successful operation of the Industrial Fund:

- because it is misconceived, is misdirected, and attempts the impossible, traditional cost accounting is at once overelaborate, inadequate, and misleading.¹²

The basic reasons for these problems are outlined very succinctly by Koontz and O'Donnell:

The techniques employed by accountants in accumulating and reporting cost information have been a source of criticism. Although problems exist in the accurate accumulation of direct-labor and material costs, largely because of the need for correct and complete basic records of time and material, the principal criticisms are aimed at the many arbitrary allocations of common costs. In any business operation there are a number of costs, such as supervision, power, maintenance and rentals, that can hardly be traced to the individual unit produced. There are in addition variances of many kinds such as those resulting from vacation pay, shift bonus, scrap, and price differences, that must be allocated in some way. In the course of allocations of costs that cannot be directly traced to the unit of output, it is only natural that cost accountants should make some arbitrary allocations.¹³

¹²B. E. Goetz, Management Planning and Control, (New York: McGraw-Hill Book Company, Inc., 1949), p. 137.

¹³H. Koontz, C. O'Donnell, Principles of Management, (New York: McGraw-Hill Book Company, Inc., 1955), p. 607.

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the following, which will give you a better idea of the situation.

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Having weighed the advantages and disadvantages outlined in this and the preceding Chapter, and having decided that an activity is well-suited to this method of financing, a panel of staff experts, in conjunction with key personnel from the station to be converted installs the Industrial Fund system. The salient features of this undertaking are the description of the plant, its current mission, future plans and present financing system; a proposed charter is drawn up, which describes the functions of the establishment, the financing and billing systems, the initial working capital and other capital. An Industrial Fund Handbook, tailored to the missions and requirements of the station is written; this book contains detailed instructions for the maintenance of all accounts, and the preparation of all reports. When the handbook has been issued, station personnel trained, cost centers are established, and the station is chartered.

The greatest problem encountered in newly chartered activities, and the one which is most persistent, is that of personnel training.¹⁴

In a most illuminating review of the progress made by the Naval Gun Factory, Cdr. R. J. Duryea found this plight very serious:

At the outset, a serious personnel problem was evident. The bulk of accounting personnel, obtained from the former Fiscal Department, where the appropriation system of accounting was employed, did not understand the double entry system required by the Navy Industrial Fund. This was aggravated by any number of factors. The loyalty of civilian personnel was still with their former department where they had been trained and understood the scope of their duties. In the Comptroller's Department they felt insecure. They did not understand this entirely new approach to accounting problems, and as a

¹⁴Notes from presentation by Mr. Marshall and Mr. Finney, Navy Comptroller Office, to the Navy Comptrollership Class.

result felt that their jobs were in jeopardy. - - - In retrospect, it is evident that the basic error was to attempt such a vast and complex project without having the assurance that the accounting personnel were properly trained for the double entry system of bookkeeping. The few supervisors and professional accountants available were entirely inadequate. It would appear mandatory to thoroughly survey the qualifications of personnel, and to institute a comprehensive training program at least six months before a change-over to the Naval Industrial Fund is made.¹⁵

¹⁵Cdr. R. J. Duryea, U.S.N., "The Navy Industrial Fund at the Naval Gun Factory," a paper prepared for the Navy Comptrollership Program, George Washington University.

CHAPTER IV

CONCLUSIONS AND SOME APPLICATIONS

The preceding pages have dwelled at some length on the merits and shortcomings of the Industrial Fund system, as opposed to the traditionally used allotment method of financing military field activities. In addition, we have made an abbreviated exploration of the actual mechanics of the Fund's operation; a discursive treatment of the workaday administration of the accounting procedures has been intentionally avoided. Suffice it to say that the Industrial Fund Handbook, tailored specifically for each activity chartered under the Industrial Fund, contains a complete chart of accounts for the individual station, with minutely detailed instructions for maintaining these accounts. From a management point of view, a brief discussion of the budgetary process is more applicable. We have seen, to paraphrase, that there appear to be two vital requirements of the budget for an industrial-funded enterprise:

1. Because of the all too fallible prediction of work-load for an ensuing period, our budget's primary requisite is that of flexibility.
2. By virtue of its importance as a dynamic assessor of cost-data, and the principle of "management by exception," the budget must be accepted at all management levels; in short, the human element, as applicable to the budgetary process must be recognized.

Indulgence is requested for the author's apparent too-rapid preoccupation with this principle of budgetary understanding within

the command; however, no budget, or budgetary process can be successful unless fully supported by those responsible for all details of its execution:

In probing this question further, it soon becomes evident that attitudes are the key to successful budgeting. When the attitudes of people toward each other are generous, understanding, and based on mutual respect, any technique adopted by management to further good performance is apt to be successful. When human attitudes are dominated by distrust, criticism, and recrimination, budgets are apt to fail miserably. By a strange twist of human nature, in such cases the budgets and those who defend them bear the brunt of the blame, for more fundamental errors having nothing to do with budgets.

For budgeting itself is an attitude. It is a trained, disciplined approach to all problems which recognizes the need for standards of performance in order to achieve a result.¹⁶

Many of the arguments favoring and opposing the usage of the Industrial Fund system have been presented in Chapters II and III. It seems that no single argument for the Industrial Fund, tout ensemble can be presented in a conclusive manner. The Fund has its supporters and its detractors at all levels of the Government/military administrative structure. It provokes debate at the Congressional level as well as at the level of the operating station. It has been argued in the House of Representatives that usage of Industrial Fund financing of military establishments will deprive the Congress of one of its most jealously kept prerogatives - control of the purse - which now, more than ever before is of overwhelming importance:

- - - the Military Establishment seems to be launched on a new era. The policies that this country has adopted in its conflict with the Soviet Union have projected American military as well as economic power into world politics with unprecedented force - and at unprecedented cost. In these circumstances, the Government's

¹⁶J. L. Peirce, "Budgets and People - a Positive Approach," a paper presented to the Finance Conference of the American Management Association, at New York, 1953.

legislators and Administrators must exercise their authority over the armed forces more effectively than they have in the past - - -. ¹⁷

The contention is that by placing so much control at the local level, that of the station Commanding Officer, the Congress will lose a corresponding portion of its control. Mr. W. B. Franke, Assistant Secretary of the Navy, Financial Management states that the converse of this theory is true; that through a modernized system of bookkeeping and reporting, and a corresponding facilitation of the review procedures, the Congress can actually exercise more control than under the allotment system. ¹⁸

The author's reaction, after gathering material for this paper, and lengthy discussions in the divers Offices of the Defense Department, is that the Industrial Fund has been eminently successful at truly industrial-type activities; nevertheless, the advisability of using it at the Naval Air Station is questioned. Within the Overhaul and Repair Department it could very conceivably operate - but to what end? A modification of the compromise systems discussed in Chapter III has also been suggested; that of placing a station on the Industrial Fund basis, with the exception of all departments of a strictly military nature and mission. These would remain on an allotment financing system. The advantages of super-imposing one financing system on another, with full reporting and accounting for each still required, are not immediately apparent. It must be borne in mind however, that similar objections have been raised in the past - and

¹⁷E. Huzar, The Furse and the Sword, (Ithaca: The Cornell University Press, 1950), p. vii.

¹⁸Subcommittee on Appropriations, United States House of Representatives, Hearings. 84th Congress. (Washington: Government Printing Office, 1955), p. 61.

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2. *Example of a full-scale research project* (1990-1991)

4. <http://www.4mat.com>

The above is a summary of the information received from the various sources mentioned above. It is not intended to be a complete and exhaustive account of the situation, but rather a general overview of the facts as they are known at this time.

and leading discussion to the diverse effects of the various substances.

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15. The following table shows the number of people who attended the concert in each age group.

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at present a student at the Federal Polytechnic, Bonn, with the intention of

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overcome by the use of the tailored Handbook, and modernization of existent practices.

The characteristics and advantages of Industrial Fund financing, discussed in Chapter III have also been more succinctly outlined by the Office of the Navy Comptroller:

- Provides local flexibility.
- Gears level of operations to workload.
- Provides supplier-consumer relationship.
- Provides simplified financing in a single no-year appropriation.
- Emphasizes end-product costs.
- Provides a business-type approach.
- Creates cost-consciousness among purchasing units.
- Makes it possible for management to deal with single end-product costs.
- Pinpoints areas of inefficiency.¹⁹

The installation process of the Industrial Fund may be summarized by a list of seven steps:

1. Proposal.
2. Management review and approval, from the initial survey report.
3. The Joint Panel detailed survey.
4. Review and approval by the Department of Defense, the Bureau of the Budget, and Congress.
5. Preparation of the Handbook.
6. Training of personnel.
7. Installation.

The Industrial Fund, we find, is a controversial topic, at all levels of management. It's installation has been opposed in nearly all

¹⁹Notes from presentation by Mr. Marshall and Mr. Finney, Navy Comptroller Office, to the Navy Comptrollership Class.

1. The first of these is the fact that the
2. Government has been unable to secure
3. the necessary funds to carry out its
4. policy of non-interference in the
5. internal affairs of the country.
6. This is due to the fact that the
7. Government has been unable to secure
8. the necessary funds to carry out its
9. policy of non-interference in the
10. internal affairs of the country.

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bureaus whose field activities have been so financed; however after several months of operation, it's success has been so pronounced that even its most vehement detractors have become staunch advocates.²⁰

One further question is thought-provoking, and worthy of argument: Would the Industrial Fund stand the test of mobilization, in the event of a national emergency? When the emphasis is on military strength, and not the actual cost of this strength, it is possible that the complex structure and the immediate unimportance of overhead rates and budget adherence might render the system too cumbersome for the mobilization effort. In contention, its proponents prescribe the Fund as a most propitious and flexible instrument to effect an orderly and rapid mobilization, with the minimum disruptive effects on the military economy.

In view of the success thus far encountered in the business-type approach to military financing, what lies in the future for the Industrial Fund? It has been shown in Chapter II that the mechanics of operation of the Fund are similar to those of a good-sized manufacturing business. The same accounting methods and procedures are used, the same records and reports are maintained, and the same cost-systems are utilized. In order to fully complete the simile, it has been suggested to fully capitalize all assets - buildings, land, and plant equipment.

This will necessitate depreciation of assets, and provision for funded reserve for expansion and replacement at the station level. In this same vein, military pay may very possibly become a portion of the overhead supported by the Industrial Fund activity. Were these two possibilities come to pass, there would exist only one difference between

²⁰Ibid.

a Navy Industrial-Funded Station and a business corporation; the military station would pay no corporate income tax. Industrial Fund financing in the Military Establishments will have attained the consummation of analogy to its exemplar.

REGULATIONS
COVERING THE OPERATION OF WORKING-CAPITAL FUNDS FOR
INDUSTRIAL- AND COMMERCIAL-TYPE ESTABLISHMENTS
(INDUSTRIAL FUNDS)

1. Establishment of funds:

(a) Section 405 of the National Security Act, as amended, authorizes the Secretary of Defense to require the establishment of working-capital funds in the Department of Defense for the purpose of providing working capital for such industrial-type and commercial-type activities as provide common services within or among the departments and agencies of the Department of Defense, as he may designate.

(b) Pursuant to such authority, there shall be established in each of the three military departments one consolidated working-capital fund to be known as "Army Industrial Fund", "Navy Industrial Fund", and "Air Force Industrial Fund", respectively, hereinafter termed "industrial funds". Each fund shall consist of unexpended balances of cash on deposit in the Treasury, or its equivalent; accounts receivable; stores of supplies, materials, and work in process; finished goods; and all other current assets pertaining to or acquired in the operations of the establishments financed under the fund; subject to all liabilities incurred in connection with such operations. Plant and equipment used in operations of the establishments financed under each fund do not constitute part of the fund, although the purchase of certain equipment may be financed from the fund as provided in Section 5(j).

2. Authority for regulations concerning the operations of industrial funds:

(a) Section 405(g) of the National Security Act, as amended, authorizes the Secretary of Defense to issue regulations "to govern the operation of activities and use of inventories authorized by this section, which regulations may, whenever he determines the measures set forth in this subsection to be required by the needs of the Department of Defense, and when such measures are authorized by law, permit stores, supplies, materials, and equipment to be sold to, and services rendered or work performed for, purchasers or users outside the Department of Defense. In such cases, the working-capital funds involved may be reimbursed by charges against appropriate appropriations or by payments received in cash."

(b) It is further provided in Section 405(e), "Subject to the authority and direction of the Secretary of Defense, the Secretaries of the military departments shall allocate responsibility within their respective military departments for the execution of functions which each military department is authorized by law to perform, in such a manner as to effect the most economical and efficient organization and operation of the activities and use of the inventories for which working-capital funds are authorized."

(c) Subject to these regulations and pertinent provisions of law, and to the authority, direction, and control of the Secretary of Defense, as provided by law, the Comptroller of the Department of Defense is hereby authorized to issue all necessary instructions to implement these regulations and to authorize

or approve specific projects to be financed by industrial funds and the terms under which such projects shall be operated.

3. Purposes of industrial funds:

(a) It is the purpose of each departmental industrial fund to provide a more effective means for controlling the costs of goods and services produced by industrial- and commercial-type establishments and a more effective and flexible means for financing, budgeting, and accounting for such operations.

(b) When individual agencies within each department are permitted to be completely financed and to order and pay for goods and services furnished by industrial- or commercial-type establishments (rather than to obtain them free), the officials of those agencies should have a greater sense of responsibility and self-restraint in limiting their orders based upon availability of funds and balancing the cost of such goods or services against the benefits and advantages of their use. Moreover, the creation of the complete buyer relationship will place the ordering agency in the position of critic of purchase prices (i.e., costs) as well as quality and delivery-speed of the goods or services furnished. (The term, "agency", as used above, means any organizational element within a department.)

(c) The industrial- and commercial-type establishments operated under the industrial fund in each department will be enabled more effectively to discharge their responsibilities by the separate financing of their operations and by budgeting and accounting according to commercial methods rather than the more cumbersome methods of appropriation accounting which are not, at present, readily adaptable to this type of operation.

(d) The use of industrial funds will permit a more complete establishment of a performance-type budget and accounting structure, in consonance with which the costs of goods and services furnished by industrial- or commercial-type establishments may be budgeted and accounted for under the program or function for which they have an end-use. Without the use of separate industrial funds it generally would be difficult and cumbersome to accomplish such end-use budgeting and accounting.

(e) The use of industrial funds will promote cross-servicing between departments in the area of industrial- and commercial-type operations because of the financial advantages cited above.

4. Requirements for the establishment of specific projects under the industrial fund:

(a) When it is believed by one of the military departments or by the Comptroller of the Department of Defense that the purposes of the use of the industrial fund will be served by bringing under it the operations of a specific industrial- or commercial-type establishment or a group of like establishments of such character, a charter shall be prepared to govern such operations, subject to the provisions of these regulations. This charter shall be required

to be approved by the Comptroller of the Department of Defense before commencement of such operations under the industrial fund. When changed circumstances indicate need for revision of a charter, amendments shall be initiated by the military department concerned and submitted for approval by the Comptroller of the Department of Defense.

(b) The proposed charter submitted governing the operations of a specific industrial- or commercial-type establishment or a group of like establishments of such character shall include the following provisions:

- (1) Designation of the agency directly responsible for management control of the establishment(s) within the department; e.g., a specific technical service, bureau, or command.
- (2) Description of functions of establishment(s) to be authorized to be performed, and nature of its products or services.
- (3) Statement as to agencies (or types of agencies) and personnel, either in the Department of Defense or outside, authorized to buy the products or services, or to reimburse the establishment for maintenance of idle or non-operating facilities or other types of non-operating expenditures. Statement of basis of charging for products or services.
- (4) Statement of initial working capital to be provided, including initial required allocation of cash from available Treasury balance of the departmental industrial fund.
- (5) A statement of any specific exceptions to the provisions of these regulations.

(c) In support of the application for a charter, the following information shall be furnished to the Comptroller of the Department of Defense:

- (1) Explanation of and justification for proposed furnishing of goods or services to other agencies outside the Department of Defense or to personnel of the Department of Defense. Explanation of basis of charging for such services.
- (2) Explanatory statement as to other agencies within the Department of Defense to be authorized to provide services to the establishment, together with description of such services and arrangements for compensation, if any.
- (3) Full information regarding the basis for and justification of the total amount of working capital estimated to

be required for the project and the amount of cash to be allocated. Information as to normal investment in inventories and estimated amount of current inventories to be made the subject of special credits for withdrawal of goods or services (see paragraphs 5(1) and (m).

(4) Information as to the expected volume of business and the source of cost reimbursements of every type during the current fiscal year and future fiscal years for which budgets already have been prepared, together with any appropriate request for transfer of appropriation balances in order to facilitate the financing of work to be ordered from the proposed establishments.

(5) Justification of any exceptions to the provisions of these regulations.

(d) The Comptroller of the military department in which the establishment is located will be responsible for development of the accounting system for the establishment(s), but he will be guided by the Office of Comptroller of the Department of Defense who will be required to approve the accounting system before it is established.

5. Assets and liabilities of industrial funds:

(a) The General Accounting Office has established the following Treasury (cash) account symbols for the three industrial funds:

| <u>SYMBOL</u> | <u>NAME</u> |
|---------------|----------------------------------|
| 17X1992 | Navy Industrial Fund (cash) |
| 21X3992 | Army Industrial Fund (cash) |
| 57X4992 | Air Force Industrial Fund (cash) |

(b) The initial cash balances of the industrial funds will be comprised of balances of certain unused appropriations to be transferred on the books of the Treasury upon request of the Secretary of Defense with the approval of the President, pursuant to the authority of Section 405(d) of the National Security Act, as amended. That Section also authorizes the appropriation of additional amounts if required in the opinion of the Secretary of Defense to provide adequate capital.

(c) Each department will make administrative allocations or adjustments of cash within the consolidated Treasury account from time to time, with the approval of the Comptroller of the Department of Defense, for the account of each establishment to be operated under the industrial fund. Such administrative subdivisions of the cash account will be termed "project cash accounts". Such allocations shall be made within the limitations of working capital established by the Bureau of the Budget (see Section 10). Any portion of the aggregate industrial-fund cash account of any department which is not allocated for

the use of establishments operated under the fund shall be considered to be held in reserve.

(d) All cash receipts of all establishments operated under an industrial fund of any military department shall be deposited in the Treasury, to the credit of that department's consolidated cash account, and all disbursements of such establishments shall be drawn against that account, but such transactions shall be recorded in the project cash accounts in such a manner that the aggregate of the transactions and balances in the project cash accounts and the unallocated reserve shall be in agreement with the consolidated cash account in the Treasury.

(e) Each department is also authorized, with the approval of the Comptroller of the Department of Defense, to capitalize inventories on hand in an establishment to be operated under the industrial fund of one of the departments, within the limitations of working capital established by the Bureau of the Budget (see Section 10). Such inventories may consist of (1) materials and supplies, (2) work in process, and (3) finished goods.

(f) While normally each establishment will have an inventory of materials and supplies to be used in its operations, wherever any portions of the materials and supplies required by the establishment are carried in a consolidated inventory supporting many other activities not financed under the industrial fund, it may be appropriate to finance such consolidated inventories through the departmental revolving stock-fund, or appropriation purchases account or other appropriate account, rather than the departmental industrial fund. In that case the industrial establishment would not capitalize such inventories, but would, in effect, purchase such materials and supplies at the time of withdrawal for use, subject to the provisions of Section 8(d).

(g) These regulations are not to be construed as modifying departmental policies relative to central procurement, central storage, and inventory control of materials and supplies.

(h) Normally the inventory of work in process of each industrial establishment will represent those operating costs which have not yet been billed for reimbursement to the fund.

(i) Amounts billed pending reimbursement shall be termed "accounts receivable".

(j) While each industrial establishment shall keep account of the cost of items of real estate, equipment, and other facilities used in its operations or located on its premises, such assets shall not be considered to be held for the account of the industrial fund. Replacements of and additions to such property and equipment shall be financed by appropriated funds and not by the industrial funds, except that costs of all tools and similar equipment which have a normal life in use of less than one year, or special machinery or equipment which is acquired specifically for use on specific project orders established under current appropriations, may be financed from the industrial fund as operating costs to be reimbursed as a part of the entire cost of work to be performed. All costs of repairs of plant and equipment of such establishments shall be paid from the industrial fund and treated as an operating cost, except as otherwise

specifically provided. The foregoing requirements shall not prevent the limited accumulation of insurance reserves in the industrial funds for the purpose of replacement or repair of plant and equipment to any property damaged or destroyed by fire or other hazards in establishments operated under the industrial funds, provided that such reserves are administered pursuant to regulations issued or approved by the Comptroller of the Department of Defense.

(k) The initial liabilities to be assumed in connection with the operations of each establishment to be operated under the industrial fund generally will be confined to accrued annual leave and unliquidated obligations for goods or services to be received by the establishment. Normally accounts payable for goods or services already received will be paid from appropriations against which the obligations were originally incurred. However, all obligations for the purchase of materials and supplies, for which goods have not been received at the time of creation of the project and capitalization of its inventories, shall be assumed and recorded by the newly created industrial-fund establishment in order that the cost of such materials and supplies, when received, may be paid for from the fund and capitalized as additional inventories.

(l) As provided by Section 405(h) of the National Security Act, as amended, no appropriation may be credited with any amounts in connection with capitalization of inventories and working-capital funds. However, there will be circumstances under which it would be improper, as well as unfair to the activities financed by current appropriations, to charge appropriations subsequently, a second time, for the cost of materials and supplies originally capitalized as a part of the cost of finished products or services; these circumstances include the following:

- (1) When such materials and supplies represent stocks acquired from previous years' appropriations for the use of which no amount has been currently appropriated; and
- (2) When such materials and supplies were acquired from the current year's appropriations, before creation of the industrial-fund operation, in abnormally large amounts in relation to the year's appropriation as a whole.

In these two cases, an amount equal to the cost of such materials and supplies may be credited in the industrial fund to the account of the agency originally financing the acquisition of such inventories; this credit will be available for the withdrawal of goods and services free of cost until the first fiscal year for which a budget can be prepared making provision for payment. Such budget shall include provision for payment for the cost of all goods and services received and there shall be no further free services regardless of the special withdrawal credit established as indicated above. Any unused balances of these special credits will be returned to the capital-fund account.

(m) The amounts of cash to be initially allocated to the use of an establishment under the industrial fund and any subsequent adjustments thereof shall take into consideration the following factors;

- (1) Normally the cash requirements for any establishment shall be represented by estimates of costs to be incurred under the establishment's operations prior to the time that reimbursements may be obtained under the terms of operation of the establishment.
- (2) The normal investment in materials and supplies shall be considered. Any additional investment contemplated beyond the amount of the inventories at inception of operation under the industrial fund may be provided for by an additional allocation of cash, and conversely any excess inventories which are not to be the subject of free issue, as provided in the foregoing paragraph, shall be considered for reduction in the estimated amount of cash requirements for the establishment.
- (3) Cash requirements for accrued annual leave assumed by the establishment shall be based on the following: Whenever the amount of leave assumed is greater than that which normally would be carried by the establishment under normal operating conditions, such excess may be a factor for consideration in securing the initial amount of cash. The entire amount of annual leave assumed shall be established as a liability in each case, however.

6. Orders for work to be performed:

(a) Wherever a department or agency of the Department of Defense orders construction, manufacturing, or similar work from an industrial- or commercial-type establishment within that department or another department of the Department of Defense, it shall issue a project order in accordance with approved regulations for the use thereof. This order shall serve as a basis for undertaking the work, billing the ordering activity, and for the obligation of appropriations of the ordering agency in the same manner as a purchase order or contract with an outside industrial establishment.

(b) In the case of recurring services, such as laundry service, ordered by an agency from a commercial-type establishment, either in that department or some other department, a single authorizing document should be issued for the entire fiscal year. In this case, the ordering agency will record as obligations amounts due for work performed. Such orders for recurring service should be cancelled at the end of the fiscal year and new orders issued.

(c) When special credits for free withdrawal of goods or services are permitted -- paragraph 5(1) -- project orders issued against such credits shall be recorded but shall not be treated as obligations against appropriations for the purpose of determining available balances.

(d) Work may be performed, upon requisition, for other Government agencies, for foreign governments, or for Government personnel, when so authorized by law and by charter of the establishment.

7. Reimbursements for work performed and for other costs:

(a) As a general principle, each establishment operating under an industrial fund shall be reimbursed regularly for all costs of work performed or for other costs incurred not related to production of goods or services, with the objective of maintaining the working capital established in the fund.

(b) No working-fund advances shall be made in connection with work ordered by any agency within the Department of Defense from an establishment operated under an industrial fund. Working-fund advances may be obtained from agencies outside of the Department of Defense for work ordered by them, in accordance with regulations of the department responsible for the management of the industrial- or commercial-type establishment which will perform the work.

(c) So far as feasible, each industrial- or commercial-type establishment will bill ordering agencies for work performed upon the basis of jobs completed. The cost of such jobs may be billed daily on an individual job basis, or on a weekly or monthly basis for groups of jobs completed. However, wherever a long period of time is required in the performance of a project order, periodic progress payments approximating costs incurred may be provided for in the same manner that such payments are provided for under contracts with outside parties.

(d) Certain work may be performed without cash reimbursement against special credits as provided by paragraph 5(1).

(e) The methods of determining the amounts to be reimbursed to each industrial fund by ordering activities are as follows:

(1) Any ordering agency within the Department of Defense shall reimburse the industrial- or commercial-type establishment with whom the order is placed for actual costs incurred by that establishment, excluding military pay and allowances, depreciation, and all other items of statistical costs (see Section 8 on cost accounting). When appropriate, however, predetermined prices or rates, based upon cost estimates, may be used in billing and obtaining reimbursement from ordering activities.

(2) Any personnel of the Department of Defense or outside agency ordering work performed by an industrial- or commercial-type establishment, as authorized, shall be charged the full cost, including military pay and allowances, depreciation, and other elements of statistical cost. The excess of the amounts billed on this basis over costs actually incurred by the establishment shall be deposited periodically in Miscellaneous Receipts of the Treasury.

(f) Reimbursements by ordering agencies shall be made promptly by them with the use of Form 1080 in the usual manner. The Comptroller of the Department of Defense may issue rules providing for the collection by industrial- or commercial-type establishments of delinquent accounts receivable from agencies within the Department of Defense by use of transfer-and-counter warrants.

(g) No establishment operated under an industrial fund shall include in its cost of operation, costs incurred which are not applicable either directly or indirectly to productive work. These would include costs of additions to plant and equipment, costs of removal and salvage of items of plant and equipment retired, costs of maintenance of idle plant and equipment, and cost of operation and maintenance of activities physically located in the establishment but not participating in the production of goods and services. Such costs shall be provided for by allotments from the appropriate departmental agency and may be financed either by direct charge to the allotment or by payment from the industrial fund with subsequent reimbursement from the appropriate allotment to the industrial fund by use of Form 1080. Authority for and limitation upon expenditures of this nature shall be provided by allotments from appropriate departmental agencies. The same procedures shall be followed with respect to subsistence and the cost of operation and maintenance of public quarters.

8. Cost accounting methods:

(a) Wherever appropriate, the job cost accounting method shall be followed in collecting and determining the costs of any particular project order. When predetermined or estimated costs are used as a basis of billing and obtaining reimbursement from ordering agencies, actual costs of work performed may be determined by classes of work rather than by individual jobs for purpose of comparison of actual costs and predetermined costs billed to ordering agencies; adjustments of the predetermined prices will be required from time to time, with the objective that in the long-run total reimbursements shall be made as nearly as possible to actual cost.

(b) Each type of establishment shall have a cost accounting system "custom-built" for its operation. This system shall observe the accrual basis of accounting and employ the double-entry method of bookkeeping. Books and records of account and documents supporting transactions shall be kept at the office(s) of the respective establishments operated under the industrial funds.

(c) Costs of each project order or class of work performed shall be computed for the purpose of billing the ordering agencies upon the principle of excluding those items for which the expenditures are not made by the performing establishment. The excluded costs not paid by the establishments in the beginning will include those pertaining to military pay and allowances, injuries and damages paid through the U. S. Employees Compensation Commission, the share of the Government's contribution to the Civil Service Retirement System, building occupancy in some cases, and some indirect costs sustained by the Department of Defense and other agencies of the Federal Government outside of the limits of the industrial establishment such as costs of procurement, storage, and issue of materials and supplies incurred in the basic supply system. Because depreciation on Government owned plant and equipment will not be "funded", this element of cost will be treated similarly to other excluded costs. However, to the extent feasible, all such excluded costs shall be determined and recorded

statistically in order that the approximate full cost of all work performed, from the standpoint of the Federal Government as a whole, shall be determined as well as those costs incurred for which reimbursements will be made. The objective shall be pursued of reducing the amount of statistical costs for each establishment to a minimum by taking all steps that are feasible to require each establishment to pay all costs.

All persons desiring to compare total costs of production in defense industrial- or commercial-type establishments with costs of similar private establishments should be advised of the difficulty of full comparison of costs — although a private establishment pays taxes, insurance, etc., where the Government pays none, the Department of Defense is engaged heavily in training and in the operation and maintenance of facilities and organizations under peacetime conditions for use in an emergency, which operations are not necessarily economic from a business viewpoint, and it is not possible in every case to identify all nonproductive costs.

(d) Materials and supplies used from stock, as determined either by pricing issue requisitions or by inventory methods, shall be priced in accordance with procedures established by the respective departments in accordance with the policy established or regulations issued by the Comptroller of the Department of Defense. Wherever materials or supplies are acquired from a stock fund of one of the departments, or from appropriation purchase or other accounts, the stock fund or other appropriate account shall be reimbursed for the cost determined in accordance with pricing procedures similarly established. No materials or supplies shall be issued free of charge for any job, nor shall any goods be received free of charge from any other activities for the account of any job, except for such items as are normally supplied to outside contractors for assembly, usually known as "Government furnished materials". Whenever appropriate, direct and indirect materials and supplies shall be costed separately in the accounts; indirect materials and supplies shall be treated as overhead costs.

(c) Civilian labor and salaries shall be charged to jobs at actual cost. Charges for direct labor may be priced to include overtime and provision for annual and sick leave. Charges for indirect labor, including administrative salaries, shall be treated as overhead costs and such charges may also include provision for overtime and annual and sick leave. Wherever overtime and annual or sick leave and holiday time are not provided for in accordance with the classification of cost accounts for salaries and wages, separate overhead cost accounts for such elements of cost shall be provided. Annual leave will be charged as it accrues; charges for sick leave and holiday time may be provided from month to month on the basis of experience, but for each fiscal year as a whole the amount of sick leave and holiday time charged shall be adjusted to the amount actually paid for the year, because there is no ultimate cash liability for sick leave not taken. The Comptroller of the Department of Defense shall establish uniform regulations for accounting for annual and sick leave and holiday time.

(f) Overhead costs shall be accounted for by whatever organizational units within an industrial establishment are appropriate from the standpoint of cost control and relative accuracy of costs of project orders to be billed

to different activities. From the standpoint of pricing individual jobs, any generally accepted method may be used provided it meets the test of reasonable accuracy as well as simplicity. In general, overhead costs applicable to idle plant or facilities will be separately determined and made the subject of separate reimbursement from appropriations managed by the agency responsible for the management of the particular industrial-type establishment. In general, it will be expected that overhead rates will be established for the purpose of costing products or work performed in a manner that will prevent, in the long run, any loss to the industrial fund used to finance the particular establishment.

(g) As used in the preceding paragraph, the cost of idle facilities is not intended to include the cost of maintenance of the reserve fleet, reserve aircraft, and other military equipment stored at the establishment. The cost of maintenance of such items of equipment shall be accumulated, determined, and reimbursed periodically from appropriations by agencies responsible for the storage of such reserve equipment. In a similar manner, costs of operation or maintenance of non-operating facilities within the industrial establishment, such as supply depots, air fields, and cemeteries, shall be accumulated, determined, and reimbursed periodically from appropriations. The same procedure shall be followed with respect to subsistence and the cost of operation and maintenance of public quarters for officers, enlisted men, and civilians. In the case of civilians, rent charges shall not be treated as revenue of industrial funds; in the case of military personnel, the foregoing costs are connected with military pay and allowances which are required to be treated as statistical costs.

9. Obligations and expenditures:

(a) The authority to incur obligations for each industrial- and commercial-type installation financed by industrial funds shall be vested in the local management under the direction and supervision of the agency having management control.

(b) Because it is required that documents supporting expenditures shall be retained upon the site by each industrial- or commercial-type installation financed by industrial funds, as well as because of the placement of responsibility upon local management of each installation for incurring obligations and for maintaining accurate and current accounts, (1) all documents supporting expenditures of each installation shall be processed within the installation, and (2) unless a separate disbursing officer is assigned to any installation, one or more certifying officers shall be appointed at the installation and they shall be required by administrative action to assume the legal responsibility of the disbursing officer outside the installation who shall sign checks in reliance upon such certification. The use of separate certifying officers shall not, however, relieve disbursing officers from the responsibility of reviewing the documents in support of payments under commercial or travel vouchers from the standpoint of regularity and legality.

(c) Statutory limitations or restrictions on expenditures of appropriated funds are applicable also to expenditures made under industrial fund operations.

(d) Expenditures of each industrial- or commercial-type installation operated under an industrial fund shall be limited by (1) authorized project orders to which they are chargeable, either directly or indirectly; (2) expense budgets in the case of non-operating expenses; or (3) procurement budgets in the case of materials and supplies purchased for stock.

10. Budgets and budgetary control:

(a) Each agency which may order work performed from an industrial- or commercial-type establishment shall budget annually for the estimated cost of the project orders to be placed therewith. Similarly, each agency responsible for the management of an industrial-type or commercial-type establishment operated under the industrial fund shall budget for the estimated cost of maintenance of idle plant and equipment of such establishments, the estimated cost of additions to plant and equipment, and the estimated cost of removal or salvaging plant and equipment retired. Wherever any industrial establishment has a non-operating activity under its management, such as a supply depot, an airfield, or a cemetery, the agency having management control over such activity shall budget for the estimated cost of its operation.

(b) Each establishment operated under the industrial fund shall prepare a commercial-type budget annually, covering the operating costs of the establishment upon the basis of cost accounting adopted and showing how such costs will be financed. Such budgets shall be reviewed at least quarterly and adjusted as circumstances warrant.

(c) Budgets for procurement of materials and supplies for stock shall be prepared and used administratively in procurement control by the respective establishments or by their managing agencies through the use of allotments in the same manner as procurement under appropriations. Such procurement budgets shall be based upon consumption budgets and required stock levels. The budget for materials and supplies to be consumed shall be in agreement with amounts estimated to be consumed as shown by the budget for the estimated cost of operations of each establishment.

(d) Each agency ordering work performed from an industrial establishment shall record obligations when project orders are placed, or in the case of recurring services of relatively minor amount, when work is performed. (The estimated aggregate amount of orders for such minor sums shall, if department procedures so provide, be included as a single entry in obligations recorded each month.) These agencies will record expenditures as reimbursements are made to the performing establishments in accordance with bills rendered for work performed under such project orders. Each agency responsible for the management of an establishment operated under the industrial fund will make allotments to such establishment to serve as a basis for authorization and control of costs to be incurred for additions to capital assets, costs of removal or salvaging plant and equipment retired, and maintenance of idle plant and equipment. Agencies responsible for the management of non-operating activities located in industrial establishments shall issue allotments similarly to authorize and control obligations and expenditures for such purposes.

(e) A limitation on the working capital available for the operation of each industrial fund shall be approved annually by the Bureau of the Budget.

For this purpose there shall be submitted through the Office of Comptroller of the Department of Defense to the Bureau of the Budget, in triplicate, not later than June 15 each year, an estimated consolidated balance sheet as of the beginning and end of the ensuing fiscal year and an estimated operating statement covering the ensuing fiscal year, together with supporting financial statements for each establishment. These financial statements will be based on the best estimates of the financial data reported therein available at the time such statements are prepared. A description of the proposed major financial policies relating to each industrial fund and of the programs affecting it, with an explanation of any significant changes therein from the previous fiscal year, shall also be submitted with these financial statements.

The limitation for each industrial fund will be based on the requirements for working capital of the establishments authorized under each fund with particular consideration to the anticipated activity of the projects and the inventory requirements thereof. Working capital in excess of the established limitation will be placed in reserve as of the date or dates determined by the Comptroller of the Department of Defense or the Bureau of the Budget by adjustment of the amounts allocated in the Treasury cash account of the industrial fund for the use of the various establishments operated under the fund. (See Section 5(c).)

A request for a revision of an approved limitation may be submitted as required for the initiation of new projects and for necessary adjustments due to increased or decreased working-capital requirements for existing projects. On the basis of its review of the activities of industrial funds during the year, the approved limitations on the working capital of the respective funds also may be adjusted by the Bureau of the Budget after coordination with the Office of the Secretary of Defense.

11. Reporting:

(a) Monthly summary operating reports shall be prepared by each establishment operating under an industrial fund in a form to be prescribed by the Comptroller of the Department of Defense. These reports shall include balance sheets and operating statements of a commercial type, together with appropriate schedules, including schedules showing cost progress and performance by appropriate work classifications. Wherever applicable, actual operating costs shall be compared with budgeted costs. Copies of these reports shall be submitted to the Office of Comptroller of the Department of Defense and the Bureau of the Budget. The monthly financial and operating reports furnished the Bureau of the Budget shall be in lieu of the Budget-Treasury Form 3, although the aggregates of cash transactions of each industrial fund will be reported by each department on one line in Budget-Treasury Form 3.

(b) As required by Section 405(c) of the National Security Act, as amended, each military department shall submit an annual report on the operations of its industrial fund to the President and the Congress through the Secretary of Defense.

(c) The character and form of such reports as are required for external use shall be coordinated through the Office of Comptroller of the Department

of Defense with the intended recipient to insure adequacy of information and form of presentation; e.g., reports required by the Bureau of the Budget shall be coordinated with that agency.

12. Auditing:

(a) Because of the decentralized pattern of accounting operations for establishments to be operated under the industrial fund, the Comptroller of each military department shall require audits of such establishments through the internal audit division of that department. Such audits shall be made in accordance with policies prescribed by the Comptroller of the Department of Defense. Copies of audit reports shall be submitted to the Office of the Comptroller of the Department of Defense.

(b) Agreement has been reached that the General Accounting Office will make the new comprehensive type of audit of all operations conducted under the industrial funds. These audits will be made at the site of operations rather than in the offices of disbursing officers responsible for making disbursements for the account of the establishment.

Recommended: /S/ W. J. McNeil
Assistant Secretary of Defense (Comptroller)

Approved: /S/ Louis Johnson
The Secretary of Defense

13 July 1950
Date

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